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DOES FIRE INSURANCE COST TOO MUCH ?

BY GEORGE URIEL CROCKER.

It may be thought presumptuous for one man publicly to criticise another man's method of business, especially when the critic is an outsider and not familiar with the details of such business. But the business of insurance is one as to which the public is deemed to have the right of criticism and, in some measure, of control, as is shown by the fact that it has long been subject to rules and regulations fixed by the legislatures of the various States.

Fire insurance is a system whereby the loss arising from destruction by fire may be distributed evenly throughout the community, instead of falling entirely upon the person who owned the property destroyed. The earliest organizations for thus distributing the fire loss were of the nature of clubs or societies, conducted on the plan of those benevolent societies of to-day, whose purpose is to distribute among their members the burdens caused by other misfortunes of life, such as sickness or accident. To-day the merits of the system of distribution of fire loss by means of insurance are unquestioned. The system has grown to great proportions, it has changed in its needs and its methods, and it has been extended so that every conceivable kind of loss by fire can now be distributed.

If an individual should own a thousand different houses of equal value, located each in a different town or city, there would, of course, be no necessity for his being insured through an insurance company. To such a man insurance would be simply a matter of book-keeping, whereby he would lay aside each year the estimated average amount of his loss. The plan is the same when, instead of one man owning one thousand houses, we have a thousand men each owning one house. In the latter case, the thousand

men put into the hands of an insurance company the average amount of the fire loss plus an amount sufficient to pay the cost of the care and distribution of the fund thus created. The insurance company then pays to each individual the value of his property should it be destroyed by fire.

It is well to emphasize thus the simple purpose of fire insurance, for the reason that it seems to be misunderstood by many people. For instance, some railroad companies having on their lines a great many small stations and buildings scattered through many towns and in different States, persist in insuring these stations through insurance companies instead of doing the insurance themselves.

When the false economy of this plan was explained to a certain board of railroad directors, the statement of one director was that he could see that it had been foolish to insure all these stations in the past, but it would be more foolish to stop insuring now, while there was a chance that the company might get some of the money back again should there happen to be a prevalence of fires along their line. It is a sad fact that this argument was convincing to the other members of the board, and the policy of insuring through insurance companies was continued.

The question to be discussed in this paper is whether the machinery for this distribution of fire loss has not grown too cumbersome and too expensive, and whether the public of to-day is not supporting a great mass of such machinery, which is not only unnecessary, but is wholly disproportionate to the results obtained.

To-day we find that the amount of premiums paid into insurance companies is *double* the amount paid out by them for fire loss. In twenty years in Massachusetts the people have paid to the companies \$148,000,000 for protection against loss by fire, while only \$77,000,000 has been paid back again to the people in payment of fire losses. In other words, the drain on the community on account of fire has been twice as great as the fire loss. That is to say, the aggregate loss to the community has been twice as great as if no insurance company existed. This means that the cost of distributing the fire loss has been as great as the loss itself. In other words, the cost of taking care of and of distributing the insurance fund which is paid in by the public, bears nearly as great a ratio to the total of the fund as the running expenses of a railroad bear to its gross receipts.

As an evidence of the importance of this question it may be said that one of the best known insurance men of this country has called attention to the fact that in the United States \$150,000,000 worth of property is annually destroyed by fire. If we add to this loss the cost of its distribution, we have a grand total of \$300,000,000, or more than the average annual expense of maintaining the National Government for the past ten years.

What is the cause of this tremendous cost of distribution?

It does *not* go in profits to the insurance companies. The insurance business has not for many years been profitable to the stockholders of insurance companies. Further than this, it is not necessary for most insurance companies to make any profit out of premiums in order to pay handsome dividends on their capital stock. As an illustration: An insurance company in Connecticut makes returns to the Massachusetts Insurance Commission that it has a capital of \$4,000,000, but that it has investments of the market value of nearly \$11,000,000 which bring to it an income of \$470,000 yearly. Here is a profit of over 10 per cent. on the capital stock, derived from the investment of that capital stock and of its unearned premiums and surplus. Illustrations of this kind could be multiplied indefinitely, showing that the investments of insurance companies earn handsome dividends on their capital stocks, and in many cases make up for the actual loss incurred in the insurance business.

The great cost of distributing the fire loss is *not* due to competition between the companies.

We seem to have this anomalous condition of affairs: namely, that the insurance companies complain of making no money, and at the same time there is a complaint on the part of the public that there are not sufficient companies with which to place all the insurance needed. The *Boston Herald*, in a recent editorial article on the subject, makes the statement that:

"In the central part of our city there is hardly a merchant carrying a considerable stock of goods who can obtain the protection against fire which he wishes."

The great cost of distribution of fire loss is not universal the world over. In the first place, a great difference in the rates of insurance is found in different parts of the world. In an address

at Manchester, England, Mr. H. O. Essex, of the Lancashire Insurance Company, estimates the average rates as follows :

France.....	8 cents	per \$100	Austria.....	38 cents	per \$100		
Germany.....	15	"	100	Russia.....	61	"	100
England.....	20	"	100	United States.....	100	"	100
Australia.....	38	"	100				

This estimate has been copied by insurance journals in the United States as well as by the daily press, and the accuracy of the rates does not seem to have been questioned. A similar statement as to English rates may be found in *Whitaker's Almanac* for 1894, which gives the following summary:

Common Insurances, rate 8 to 10 cents per \$100.

This rate is for buildings covered with slates, tiles, or metals, and built on all sides with brick or stone, or separated by party walls of brick or stone which are carried through the roof, and used for residence or non-hazardous purposes.

Hazardous Insurances, rate 12½ to 17½ cents per \$100.

This rate is for buildings of timber and plaster, or not separated by partition walls of brick or stone, or not covered with slates, tiles, or metals, and thatched barns or outhouses having no chimney, and buildings falling under the description of common insurances, but in which hazardous goods are deposited, or hazardous trades are carried on.

Doubly Hazardous Insurances, rate 22 to 25 cents per \$100.

This rate is for all thatched buildings having chimneys, or communicating with or adjoining to buildings having one, although no hazardous trade shall be carried on, nor hazardous goods deposited therein, and all hazardous buildings in which hazardous goods are deposited or hazardous trades carried on.

Much depends upon the surroundings of the building insured ; for a printer's or bookbinder's workshop in a narrow lane, with old wooden houses near it, the premium would be possibly from 50 to 75 cents per \$100.

Special insurances, 25 cents and upwards.

These rates are for buildings and contents, among others of workers in wood, dealers in mineral oils, large drapers, some mills, warehouses, and factories. In the case of some theatres the rate is as high as \$1.55 per \$100.

The claim has been made by insurance men that these differences in rates between this country and abroad are due simply to the fact that fires do not occur in Europe with the same frequency

and with the same disastrous results as in this country. It probably is the fact that better building methods are in vogue in Europe than in this country, and that this fact has some effect upon the rates. But when we find rates in the United States twelve times higher than in France, and five times as great as in England, some proof of the fact that this difference is due entirely to better building methods should be offered. No such proof, however, seems to be at hand. We find, however, in comparing cities in Europe and America, according to population, and then according to fire loss, that the fire loss is somewhat less abroad than in this country. As an illustration, it appears that the fire loss in Paris for the year 1890 was \$1,845,265, while the loss in Boston during the same year was \$960,847. The population of Paris is about four times as great as that of Boston, while the fire loss is only twice as great. It may be said that such a comparison is not of great value, but, in the absence of anything better, it may be taken for what it is worth.

Having told what are *not* the causes of the great cost of conducting the insurance business, the question arises what *is* the cause? And there also may arise this question: If the companies are not making money, and if they seem to be unable to find a way to make money, but, on the contrary, are retiring from business in considerable numbers each year, is it not rather foolish to try to discover any cause? Are not insurance men as intelligent and as active a class of men as any in the community? Are they not as anxious to make a profit as any other class of men? If there were any waste that could be stopped, would they not, and could they not, find it out themselves without the help of any outside inexperienced critics? Then, too, if by reforming any present methods, profits to the insurers and lower rates to the insured might be brought about, why are there not intelligent men enough in the community, with plenty of capital, to go into fire insurance business and show how it ought, to be done?

The answer to these questions lies in a consideration of who and what are the "insurance men" of this country.

In the first place they are *not*, as a rule, stockholders in the insurance companies, and, as such, interested in the financial success of those companies. The large stockholders of the comparatively few remaining United States companies are not concerned

in their active management. The officers, in most cases, receive small salaries, but make up for the smallness of their salaries by the commissions which they receive on the business which is brought to their companies.

If one considers who are meant by "insurance men," as a class, it will be found that the persons thus designated are absolutely and entirely *insurance agents and brokers*. It is not intended by anything said here to question the personal character of "insurance men," as a class. On the contrary, they have among their number many of the most intelligent, honest, and enterprising members of the community.

The whole business of fire insurance is conducted to-day by insurance brokers and agents. What is their interest? It will be said that if they are honest and faithful, as it is admitted they are, they will serve the best interests of the companies which they represent. They will not take too many risks in one place or too near together. They will not, unless they get extraordinary rates, take risks which they deem to be extra hazardous, and they will see that the money collected for premiums reaches its proper destination. They will also see that losses are justly and honestly adjusted. All of this may be admitted, but what business is it of the insurance man to look after the *profits* of the companies which he represents; what business is it of his whether the public pays twice as much for fires as the actual fire damage? If rates are high, the company which the insurance man represents gets more money, and he gets a larger income, because his compensation is calculated as a percentage on premiums. As to the public he does his duty when he charges the regular rates and no more, the said rates having been fixed by himself and his colleagues on his local board of underwriters.

So it appears that the honest and efficient agent or broker or in other words the "insurance man" has no real interest, pecuniary or otherwise, either in the profits of his companies or in the reduction of rates to the insured.

A certain rule passed by the Boston Board of Fire Underwriters a year or more ago shows that "insurance men" are not fully alive to the interests of the companies. The rule, in substance, was that if the assured would agree to maintain insurance on their property to an amount equal to eighty per cent of its value, they would be entitled to have their insurance at the

regular rate without any additions. But if the assured would agree to insure his property to one hundred per cent, or its full value, he would be entitled to a reduction of twenty per cent of his premium. Under this rule the companies were compelled to write a policy for \$10,000 for the same price as one for \$8,000 and upon the same terms. The absurdity of this rule was immediately brought to the attention of the Board of Underwriters, but it was four months before it was repealed.

An examination of the official returns of some of the more prominent insurance companies will give some further light on this subject.

Taking first, one of the large foreign companies, it is found that in six years they have paid out for brokerage and commissions, excluding salaries of officers and employees, an amount equal to 29 per cent of the amount paid by them for fire loss, and if we include salaries of officers and employees, it is found that brokers, agents, officers, and employees together, have received nearly half as much as the insured have received for fire loss.

Taking next a still larger foreign company, which has been paid in six years more than \$25,000,000 in premiums, similar facts are found. Brokers and agents get nearly a third as much as the insured get for fire loss, and brokers, agents, officers, and employees get half as much as the insured.

The same state of affairs is found in the American companies. A large Hartford company reports that it has paid in commissions an amount equal to 28 per cent of the amount paid for fire loss, and that the total paid brokers, agents, officers, and employees is equal to 47 per cent of the amount paid the insured for fire loss.

The companies here mentioned are the *best*. If extraordinary cases were being sought, there might be mentioned one small company which reports that its expenses have been a little more than *twice as great as its fire losses*.

It may be noted that what one might expect would be a large item of expense, namely, the maintenance of the system of inspections and rating of buildings and property, is not included under the head of salaries or commissions. This work is done under the charge of boards of underwriters, the expenses of which are divided among the companies, so that the expense to each company is trivial.

In short, it is found that a very large part of the money laid aside each year by the public as an insurance fund to protect against fire loss, finds its way immediately into the pockets of brokers, agents, and officers of the insurance companies. This amount is half as great as the amount that is returned to the public in settlement of losses, and is equal to at least a quarter of all the premiums paid in.

One extraordinary feature of the matter of commissions is that the insured has to pay a broker's commission on every dollar's worth of insurance, *and on every renewal*, whether he desires the services of a broker or agent or not. It is not to be denied that a broker may be of service to a person desiring to procure insurance, but that the public should have to pay a broker from 10 to 15 per cent. on all premiums, and generally a further sum as a commission to an agent, seems ridiculous.

A fact that shows the rottenness of the present system of conducting the insurance business is the custom for a broker to divide commissions with the insured to obtain his business.

It is not unusual to receive an offer of a rebate from 5 to 10 per cent of the premiums of insurance, as an inducement to deal with some particular broker or agent. It is true that this custom is contrary to law and to the rules of the various boards of underwriters, but it may be stated with perfect positiveness that it is very prevalent, as the writer knows from personal experience. If further evidence were needed on the point, it would be sufficient to point to several brokers' advertisements.

It will be understood that the labors of a fire insurance broker are entirely different from those of any other kind of a broker. The life insurance agent has first to induce a man to insure his life, but the fire insurance broker has no similar labor, for every one wants fire insurance. Having induced a man to have his life insured, there is next the question of what company is the best, and on this point every company is struggling to present evidence that it is the strongest, the most liberal, and the most economical. After the life insurance agent has finally convinced his client on all these points, he is in danger of having all his labor go for naught on account of the applicant failing to pass a physical examination. The real estate broker, the agent or broker for any class of merchandise, has all these difficulties of competition and

of demand and supply to overcome. None of these labors are required of the fire insurance broker.

The question remains why new capital does not go into the insurance business and adopt new and more rational methods whereby rates may be reduced, the commission of brokers and agents be abolished, and a profit realized on the money put into the enterprise. The answer to this question is difficult, and cannot perhaps be fully given. In the first place, the experience of those who have money now invested in insurance companies, leads them to be timid about putting new money into similar enterprises. There is also the fact to be borne in mind that any company that enters the field to-day, in opposition to present methods, must be prepared to enter a bitter warfare. All "insurance men"—*i. e.*, brokers and agents—will be against the company. The use of underwriters' ratings and inspections would be denied to the new company, for no one is allowed to examine these ratings unless he first agrees to adopt them.

On the other hand, in certain branches of insurance, as for instance in mill insurance, a break has been made from the regular system, and the result, largely due to the abolition of commissions, has been a remarkable reduction in rates.

It is possible for any company to-day to bring about a total overthrow of the present system provided that it has a capital large enough to meet the first onslaught of the upholders of the present insurance machinery, and the backing of such members of the community as would give it a credit and respectability above question. Suppose such a company make a reduction of rate of only 10 per cent, would it not receive the patronage of the public? If the company could save for itself another 5 per cent of its premiums it would gain thereby enough to make an extremely handsome dividend on its capital stock.

This above-mentioned saving is only 15 per cent in all, and is a low estimate of the average amount paid to brokers.

If this gain to the assured and to the companies could be made, simply by allowing the public to deal directly with the companies, instead of through brokers, would it not be a great step taken towards lightening the weight of the immense machinery for the distribution of fire loss?

GEORGE URIEL CROCKER.